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A review by the Federal Reserve Bank of Chicago

Business Conditions

1953 April



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The private debt

*Despite rapid growth in private indebtedness,
financial position of borrowers continues strong.*

THE LARGE INCREASE in individual and business debts since 1945 has given rise to some concern. The fear is expressed that the post-war debt growth has been excessive and, as a consequence, that the economy is steadily becoming more vulnerable to a recession.

The private debt has doubled in seven years and now stands at 300 billion dollars. In relative terms, however, its growth since the beginning of the war has not been as rapid as the expansion in economic activity, as measured by national income. Just prior to the war, private debt was a little over one and one-half times the national income. By 1945, the debt total, which had changed but little throughout the war years, was only three-fourths as large as national income; since that time, it has been rising steadily and currently is about equal to the annual income figure.

Relative growth significant

It is this relative growth, and not the absolute size of the debt, that is most meaningful in assessing the soundness of the present debt structure. Along with the debt growth, it is necessary to consider what has happened to such debt-sustaining factors as income and asset holdings.

In looking at the obligational aspect of debts, however, one should not lose sight of the vital role they play in the investment process. Rising debts facilitate investment, for it is through the borrowing process that savings, either in individual or institutional hands, and credit newly created by the banking system are channelled into investment. Thus, an increase in debt is not only to be expected in a period of rising economic activity; at the same time it serves a

constructive function in the investment process.

Debt accentuates fluctuations

On the other hand, since debt is not a passive factor in the economy, its expansion and contraction can generate excesses that aggravate business fluctuations. Credit expansion frequently plays a big part in inflation, and credit contraction has long been known to intensify recessions. Concern over the present debt situation largely grows out of this latter experience. And though debts appear to be "in line" with other economic measures, they can easily become difficult to service in a temporarily contracting economy.

In assessing the significance of a debt increase, therefore, it is necessary to consider to what extent debtors would be squeezed by declines in earnings, and how much damage would arise from their efforts to meet debt obligations by distress actions. Though detailed information is generally lacking, some inferences can be drawn from the broad aggregative data which bear on the sustainability of the current debt structure.

Corporate debt

Corporations added 80 billion dollars to their debts in the past seven years, of which three-fifths was short-term.

	1945	1952*	Per cent
	(billions)		increase
Short-term	\$47	\$ 95	102
Long-term	38	70	84
Total corporate debt.....	\$85	\$165	94

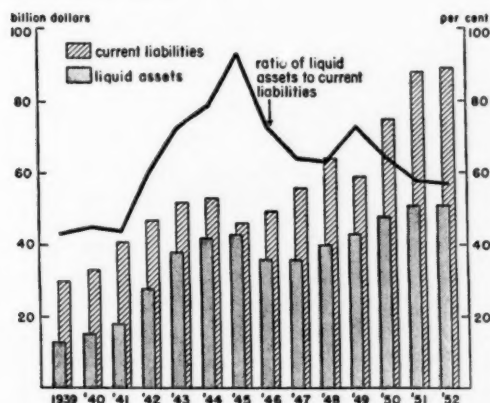
*Preliminary

This huge growth in corporate debt is in part a reflection of the unprecedented scale of busi-

ness investment in this period. Though the bulk of the capital came from retained earnings and depreciation allowances, the 32 billion dollar increase in long-term debt indicates that debt financing also was important.

In addition, the higher levels of business activity and prices resulted in a sharp expansion in trade payables and short-term debt. The rise in these obligations has been especially marked since the outbreak of Korean hostilities: short-term debt has expanded four times as fast as long-term debt in this period. This has resulted from the need for larger inventories and working capital and the rise in Federal income tax liabilities. In 1949-52, nearly a third of the total rise in short-term obligations was occasioned by increased tax liabilities, stemming from larger profits and higher tax rates. Obligations of an involuntary nature such as tax accruals tend to magnify the expansion of private debt during an upswing in business activity. This type of debt, of course, would virtually disappear if corporations were on a pay-as-you-go tax basis similar to individuals.

Corporations' current liabilities increased more rapidly than liquid assets since 1949, but the ratio is still favorable



High liquidity. Despite the large and rapid growth in their indebtedness, the financial position of corporations in general continues strong when measured by prewar norms. Coverage of short-term debts, both in terms of liquid asset holdings and total current assets, is greater than in the immediate prewar years.

Holdings of cash and U.S. Government securities by corporations other than financial institutions were equal to 55 per cent of total current liabilities at the end of 1951. Although this was a sharp decline from the exceptionally liquid position reached in World War II, it is still above the prewar high of 46 per cent.

Lower debt burden. Another factor which has eased the debt position of corporations is the lower debt service costs. Interest rates in the postwar period have averaged about half those of the late Twenties. Thus, in spite of the greatly increased volume of debt today, interest payments in the aggregate are far less onerous than a comparable debt would have entailed in the earlier period.

While interest rates have declined, corporate earnings generally have been at high levels. For all corporations, total debt at the end of 1952 was less than 4 times the earnings before tax and interest payments, as contrasted with 6 times in the late Twenties and 5 times in the years immediately preceding the last war.

When the lower cost of borrowing is set against the higher profit level that has existed in recent years, the contrast with earlier periods is quite striking. In 1925, for example, the interest paid by corporations amounted to 31 per cent of the profits available for debt service (corporate profits after taxes but including interest payments); in 1940, this ratio was 28 per cent. By 1948, owing to the relatively steady level of corporate interest costs and the large rise in corporate income after taxes, the percentage had fallen to 11 per cent.

Interest costs, however, are not the whole story. If business activity and profits begin to fall, amortization charges and demands for debt repayment may prove of crucial significance.

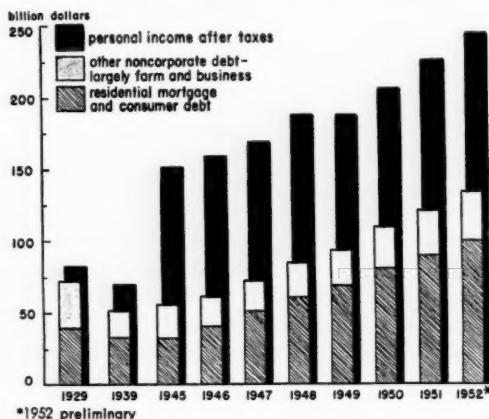
Under favorable business conditions, a large part of both long- and short-term debt is renewed. If adverse developments occur, refunding may become extremely difficult. Arranging principal repayments, under such conditions, is a much greater problem than meeting interest costs. The scope of the repayment problem depends, of course, upon the nature of the contractual obligations, the attitude of creditors, and the seriousness of the recession. Private placement, increasingly used in recent years, probably affords greater flexibility in adjusting to changing economic prospects.

Nevertheless, as long as incomes are maintained, the ability of corporate borrowers to carry the present debt load appears to be considerably better than in previous periods.

Noncorporate debt

Debts of consumers, farmers, and other noncorporate businesses, though quantitatively smaller than debts of corporations, have risen far more rapidly in the postwar period. Part of the impetus for this rapid growth came from the postwar residential building boom: out of every 10 dollars added to noncorporate debt,

Debts of individuals and noncorporate business have grown less rapidly than personal income



over six were in the form of nonfarm mortgages.

	1945	1952**	Per cent increase
	(billions)		
Mortgage (nonfarm)	\$27.9	\$ 77.3	177
Farm mortgage	4.7	6.7	43
Consumer credit	5.6	24.0	329
Farm production loan.....	2.5	9.2	268
Other*	14.8	18.6	26
Total noncorporate	\$55.5	\$135.8	145

*Includes commercial and financial debts

**Preliminary

The prominence of mortgage debt on small homes attests to the fact that home ownership has become more widespread than ever before. Three out of every four dollars added to mortgage debt were secured by one- to four-family dwellings. This amounts to a threefold rise in indebtedness on small homes, as compared with a twofold rise on multi-family and commercial and a very modest increase in farm mortgage debt.

While much of the rise in noncorporate debt, dollarwise, was in long-term mortgage, shorter-term debts have also shown sharp increases. This is especially true of consumer credit which has expanded more than 300 per cent since 1945.

This sharp rise was in part a reflection of the low level of debt at the end of the war, resulting from wartime shortages of the types of consumer goods typically purchased on credit. In the surge of postwar buying, consumers added almost 20 billion dollars to the 5.6 billion outstanding in 1945. There was a notable dampening of this rapid expansion in 1951, owing primarily to the imposition of controls limiting the terms under which instalment credit could be extended. However, the upward movement was renewed in the spring of 1952, following the suspension of credit controls at that time.

Of the remaining types of short-term debts, loans to farmers and unincorporated businesses also registered a more-than-twofold rise

—continued on page 14

The twelfth year of rent control

Almost half of all rental units still under control. Authority to end April 30 unless extended by Congressional action.

ON FEBRUARY 2, the President called for retention of Federal rent control "in those communities in which serious housing shortages exist." Unless positive action is taken, rent ceilings will expire on April 30 in such large cities as Chicago, Boston, Philadelphia, and Cleveland. If Congress agrees to an extension of this authority, rentals of 6 million dwelling units throughout the nation will continue under Federal ceilings.

If the present rent control law is not renewed, state governments may provide substitute legislation. At the present time, New York and Washington, D.C. have their own systems. In Illinois, rent control bills were under consideration by the state legislature in March.

Many areas decontrolled

Federal rent control has been in existence since early 1942. During these 11 years, the program has been the subject of thousands of pages of heated testimony before Congressional committees. Important modifications have been made in the law and many controlled rents have risen substantially, but the program survives as the longest-lived of all major direct controls.

Although rent curbs at one time covered the vast majority of all rental units, the program has never been universal. Rather, selected localities were designated "defense rental areas" beginning in 1942, and this term has continued in use throughout the life of the program. In 1951, the Secretary of Defense and the Director of Defense Mobilization were given the power to name "critical defense areas." In these localities, Federal rent control has been continued or reinstated unless local bodies have objected. All types of housing

units are under control in certified critical defense areas. In ordinary defense rental areas such as Chicago, however, there are numerous exceptions.

Largely as a result of action of local governmental bodies, the number of controlled units under the Federal program has declined over 55 per cent since mid-1947. Of the nation's 20 million rental units, about 9 million are now under some kind of control.

Since 1949, local authorities have had the power to discontinue Federal controls in their communities. On September 30, 1952, ordinary rent control lapsed in all cities which did not specifically request continuance. Over 1,000 communities throughout the nation decided against rent control at that time. Most large cities, however, asked that ceilings remain in effect. As a result, regulation was kept in force for 80 per cent of the dwellings which might have been decontrolled at that time.

Only a small group of District centers still have rent control. They include Chicago, Springfield, and Decatur in Illinois; South Bend and Terre Haute in Indiana; and Dubuque and Burlington in Iowa. In addition, several District cities have rent control because they have been designated critical defense areas. The major ones are Joliet, Illinois; Indianapolis and Gary, Indiana; Cedar Rapids, Iowa; and Royal Oak, Michigan.

Raising the ceilings

As would be expected, the rise in Bureau of Labor Statistics rent indexes for cities dispensing with rent ceilings in the past four years has been substantially greater than in cities which retained restrictions. From mid-1949 to January 1952, rents rose 23 per cent in a

group of large decontrolled cities as opposed to 8 per cent in controlled cities of comparable size.

Among large District centers, Milwaukee has had the longest experience without Federal rent curbs. They were ended in that city in August 1949. A comparison of the rise in rent indexes from that date to the fourth quarter of 1952 is given below:

Milwaukee	+46%
Chicago	+15
Indianapolis	+13
Detroit	+13
U.S. 34 cities Avg.....	+14

Detroit dispensed with controls last September 30, but statistical information concerning the rent rise since decontrol is lacking at the present time. Indianapolis is a critical defense area, and quite probably will continue to be controlled beyond April 30. Attempts of some citizens to have Chicago tagged with the critical defense label have not been successful up to this time.

Milwaukee was named as a critical defense area last autumn. Federal rent controls were reinstated, but the city's Common Council terminated the program on January 15.

In Battle Creek, Michigan, rent control was ended on October 20, 1950. A special survey taken in July 1952 indicated that the average rent increase since decontrol had been about 39 per cent. Battle Creek was certified as a critical defense area by the Secretary of Defense at the same time as Milwaukee. Local authorities in Battle Creek also removed their city from the list of those communities slated for recontrol. The Milwaukee and Battle Creek experience indicates that reinstatement of controls once they have lapsed is not likely to be approved locally.

Housing supplies improve but—

A large volume of new dwellings was added in District cities in the 1940-50 decade. Never-

theless, at the time of the housing census of 1950 there were only a small number of vacant units. The following table shows the proportion of unoccupied dwellings for the four largest District cities:

	1940	1950
Chicago	4.0%	1.7%
Detroit	3.6	1.9
Indianapolis	3.7	2.2
Milwaukee	3.3	1.7

Of the unoccupied dwellings, only those for which the owner is seeking a buyer or a renter and which are not dilapidated are considered to be "vacant." The vacancy rate was about 1 per cent for these cities in 1950, as compared with an average for the nation of 1.6 per cent. Cities such as Houston, Los Angeles, Portland and Jacksonville, Florida, where the rent increases following decontrol were relatively moderate, had 1950 vacancy rates ranging between 2.3 and 3.6 per cent.

Increased tightness in the housing market between 1940 and 1950 came about in part as a result of high tenant income and the existence of rent control, which enabled most families to afford separate living quarters. Of greatest importance, however, is the fact that until recent years the number of housing units added did not keep pace with the number of households formed. For leading District cities the percentage increase in households in the 1940-50 decade exceeded that for dwelling units:

	Dwelling Units	Households
Chicago	11.8	14.6
Detroit	18.3	20.3
Indianapolis ...	15.5	17.5
Milwaukee	11.2	13.2

Some improvement has occurred since the 1950 census, since the rate of family formation has declined while home building has continued at a high level. There is little doubt, however, that rents in large District cities still under control are well below the "free market" and would rise substantially if ceilings were lifted.

Gradual thaw in controlled areas

Sizable increases in controlled rentals have been possible since mid-1947. Largely in recognition of higher operating costs, Congress has provided that controlled units may be rented at a figure 20 per cent higher than the amount registered originally. Last year authorities in a number of cities permitted a further boost if certain minimum service standards had been maintained.

In Chicago, for example, a typical controlled apartment may rent for at least 30 per cent more than the original freeze-period amount. Moreover, increases in excess of this proportion may be allowed if the net income to the owner of rental property is determined to be inadequate upon application of a formula. In general, these increases are intended to cover higher operating costs. An additional adjustment is possible when a rental unit has been significantly improved or enlarged.

Curbs under fire

Rent control has been subjected to criticisms similar to those directed against other types of direct controls. In the main, it is argued that giving supply and demand free play in the housing market brings more equitable distribution of existing space and encourages construction of additional units. Moreover, owners of rental property complain that controls have prevented the value of their property from rising as much as other types of real estate.

New arrivals in defense rental areas may be forced to pay extremely high rents for luxury apartments for lack of other accommodations. If controlled units are available, the prospective tenant may be asked to pay some sort of lump sum bonus before occupancy. Proponents of decontrol maintain that elimination of rent ceilings would create additional vacancies and thus encourage immigration to tight labor markets.

Many of the same objections have been levelled against rent controls in Great Britain.

The Rent Restrictions Acts have governed rents for a large portion of the privately-owned rental units in Britain since 1915. Between the two World Wars, most controlled rents were allowed to rise 40 per cent from the 1914 level as a result of higher operating costs and many units were decontrolled. But in 1939 when a general freeze was invoked again, almost one-third of all householders in Britain still paid controlled rents.

Since 1918 a substantial volume of rental housing has been constructed in Britain, but by far the greatest share has been municipally-owned and operated. As a result of heavy subsidies, tenants are said to pay only 60 per cent of the cost of state-owned housing.

Most English writers accept the idea that rent controls will be retained as long as housing shortages remain because of war damage and material restrictions. There is strong pressure, however, for some upward revision of the ceilings. Houses are said to be deteriorating because of inadequate landlord income to provide adequate maintenance. There are also complaints that controls have brought wasteful distribution of housing space and that arbitrary differences exist between rents on similar properties.

Those who support rent control in areas still covered point out that Congress has continued to enact the necessary legislation only with reluctance and after careful deliberation. In 1950 and 1951 it was argued that restrictions placed on new residential building because of the defense program required a continuance of rent ceilings. Now, construction has been freed of most impediments, but the influx of defense workers into certain cities, it is said, necessitates protection of tenants.

There is little sympathy in America for perpetual control. Spokesmen for both sides look forward to eventual elimination of rent curbs along with other direct controls so that the mechanism of the free market can function most effectively. The question to be resolved is the matter of timing.

THE Trend OF BUSINESS

BUSINESS ACTIVITY has continued to climb slowly since the turn of the year, and there is little evidence that weaknesses are developing which would reverse this trend in the next few months. Industrial output rose to new highs in January and February and is now 8 per cent above that of early 1952. Retail sales declined somewhat more than seasonally after Christmas, but continue very good compared to those of a year ago, while manufacturers' new orders are holding close to the volume of sales. On the other hand, little over-all upward price pressure has been in evidence.

What concern is expressed about the near-term business outlook centers around the possibility that the rise in activity has been larger than can be sustained. Some businessmen feel that consumers are not increasing their purchases enough to absorb the larger flow of goods and that involuntary inventory accumulation and a subsequent turn-down in business ordering will be the result. This view seems to be most prevalent among distributors of consumer durable goods, stemming from the fact that production of automobiles, television sets, and appliances has increased sharply since last summer. Manufacturers assert that these lines are moving readily, however, and that the expansion in inventories which has occurred is hardly more than enough to rebuild previously depleted stocks and take care of the higher volume of sales.

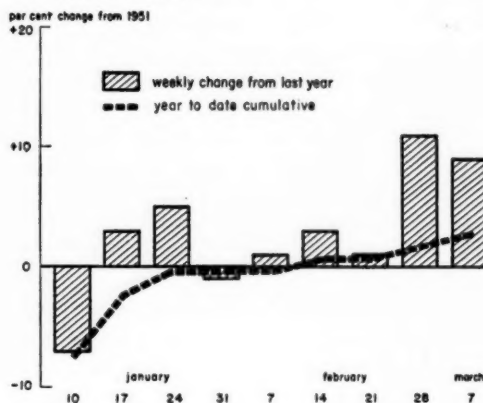
Business inventories over-all rose substantially last fall. Seasonally adjusted, the increase during the fourth quarter was the largest since the spring of 1951. The rise in each successive month was smaller than in the month before, however, and preliminary figures indicate that

a slight decline occurred in January. Moreover, total inventories at year end were appreciably lower than at the end of 1951 and about equal to 1950 in relation to the volume of sales.

The net expansion in inventories has been restricted to durable goods with stocks of non-durable goods declining in each month since October. In large part, this expansion has resulted from the rebuilding of supplies of both steel and finished goods, which had been depleted during the two month steel strike last summer. By the end of January, however, the loss had been more than made up and total durable goods inventories were 6 per cent higher than in January 1952. By way of comparison, sales increased 13 per cent in the same period.

Retail sales declined slightly more than sea-

District department store sales well ahead of last year in recent weeks



sonally from December to January, owing entirely to a reduction in sales of nondurable goods stores. The total volume was considerably larger than in earlier months, however, and exceeded January 1952 by more than 8 per cent. Moreover, an appreciable pickup in department store sales in recent weeks suggests that total retail sales, seasonally adjusted, may now have recovered their earlier highs.

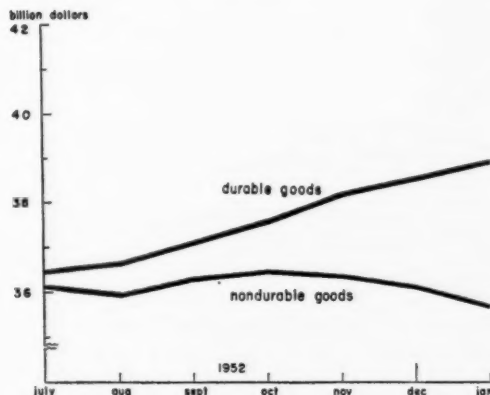
At District department stores, sales were 10 per cent ahead of 1952 in the three weeks ended March 14, as contrasted with a volume of sales averaging about the same as in 1952 during the first eight weeks of the year. Among District centers, Detroit and other Michigan cities have shown the largest advances from 1952, reflecting the increase in activity and employment which has occurred in the automobile and supplier industries in recent months. Indianapolis stores have also experienced sizable gains in sales volume from last year.

Employment has been seasonally lower in the past several months due to declines in farm and construction activity during the winter and the laying off of temporary help employed by stores and the post office following the Christmas rush. Unemployment has not increased correspondingly, however, since many of these temporary workers (housewives, students, etc.) withdrew from the labor force. In February, unemployment nationally totalled 1.8 million, 500 thousand more than in October but 300 thousand fewer than in February 1952.

The labor market continues very tight in most District centers. Unemployment as a proportion of nonagricultural employment ranged from 1.7 per cent in Michigan and Indiana to 2.4 per cent in Iowa in mid-February, as compared with a national average of 3.1 per cent. The most spectacular change in the employment situation from the early months of last year has occurred in Michigan, which has shifted from a labor surplus to a shortage area.

Housing starts have been running at very good levels in recent months. From October

Inventory rise since steel strike limited to durables



through February, construction was begun on about one-eighth more new dwelling units than in the comparable months of 1951-52. Seasonally adjusted, starts amounted to more than 1.2 million units at annual rates in both December and February. The number of residential building permits issued in the Chicago metropolitan area during February was 20 per cent larger than in the same month a year ago.

A relatively mild winter in most sections of the country may account for part of the rise in home-building activity. In addition, the ending of credit controls and liberalization of FHA and VA mortgage terms last September probably have acted as moderate stimulants to the housing market.

Prices have continued relatively steady in the wake of decontrol for most products during the past two months. Copper, sulphur, coffee, cigarettes, and some other items have posted sizable increases, but the effect on the over-all level of prices has been minor to date. The wholesale price index edged upward from week to week in February and early March, but the total gain amounted to less than 1 per cent. However, it is still too early to ascertain what the full effects of decontrol will be.

The demand for housing

Family formation is trending downward, but the need to improve existing housing standards supports active home building.

HOW MUCH LONGER can the current high levels of residential construction be maintained? This question is being asked more often and with growing concern as nonfarm housing starts during the postwar boom pass the 7 million mark. Concern springs from the increased buyer resistance encountered last year in the sale of new houses in most communities . . . from the sagging prices observed for older used homes . . . and from the moderate accumulation of completed but unsold houses experienced by many builders last summer for the first time in a decade.

But the fact that these accumulations were largely worked off during the fall without appreciable price concessions suggests that demand still continues strong. Also encouraging has been the pickup in housing starts since removal of credit controls on new construction last September. For these reasons, most observers now expect a good level of building in 1953, with housing starts perhaps exceeding 1 million units for the fifth year in a row. Beneath the surface, however, there is apprehension that the market for new housing is nearing the saturation point and that this will become evident in the not-too-distant future.

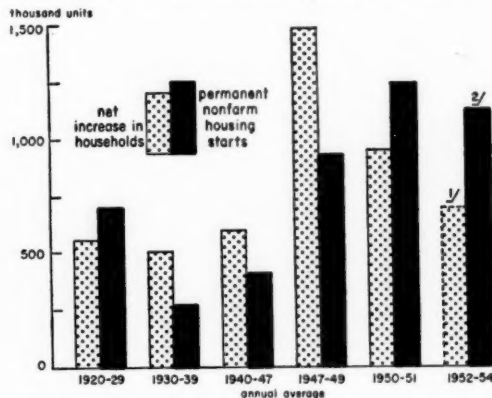
Household formation turning down

One major source of demand for additional housing stems from the *net formation of new families*. Unless these families "double up" in existing quarters, or move into the residence formerly occupied by the husband or wife alone, new living accommodations must be found and a separate household created. An important fact in appraising the outlook for construction is that household formations have already dropped sharply from the postwar high

and are expected to decline further in the years immediately ahead.

In large part, *net additions to households* result from increases in the number of married couples, which in turn are determined primarily by the level of marriages. The number of marriages was at an all-time high in the early postwar years, reflecting war-induced deferrals, prosperous economic conditions, and the large number of persons at marriageable age. Since then, however, marriages have fallen off and in 1952 were one-fourth below the 1946-48 average. Moreover, unlike the total population, the number of persons in the 20-34 age group will not increase during the remainder of the 1950's. This means that marriages are unlikely to rise from the current level for some time to come. Consequently, net

Household formation exceeded permanent housing starts by a wide margin for two decades prior to 1950



¹ Median projection, Bureau of the Census
² 1952 only

increases in the number of married couples are expected to total only about 400,000 per year, as compared with a high of more than 1 million in 1948.

This is not the whole story, however. In addition to the decline in marriages, the number of married couples living in shared quarters who seek to acquire separate homes promises to be a much smaller source of housing demand than in recent years. Economic necessity during the depression and a critical housing shortage during the war resulted in a net increase totalling more than 1.3 million between 1930 and early 1947 in the number of married couples not having their own household.

With rising incomes, plentiful job opportunities, liberal credit terms, and a high level of home building, many such couples established separate households during the postwar years. By early 1952, the number of married couples still doubled up had fallen back to the 1930 level and comprised a smaller proportion of all married couples than at any previous time.

Two additional sources of household formation stem from increases in the number of family groups not headed by a married couple and in the creation of households by individuals. These are caused largely by divorce, death of a husband or wife (which also reduces the number of married couple households), and increases in the number of unmarried adults living apart from their families. Additions to such households have required about 400,000 dwelling units annually since 1946, although there have been wide fluctuations from year to year.

The number of households formed by older persons can be expected to increase substantially in the future. Longer life expectancy is leading to a larger growth in the number of aged than in the population as a whole. In addition, widespread coverage under social security and the growth in private pension plans makes it possible for these persons to maintain separate residences rather than move in

Household formation on the decline

	Average yearly increase		
	April 1947-49	April 1949-52	April 1952- July 1955*
	(thousands)		
Net increase in married couples	959	396	400
Undoubling of married couples	352	205	25
Other family groups...	-23	122	100
Individuals' households.	196	397	165
Total additions to households	1,484	1,120	690

*Median projection

with relatives or live in institutions for the aged. At the same time, however, the number of persons in the 20-34 age group will not increase appreciably for the remainder of this decade. Consequently, the Bureau of the Census has projected the growth of individual and other family households at a reduced annual rate of about 265,000 from 1952 through mid-1955.

In total, then, household formation is expected to be substantially smaller in the next few years than in the earlier postwar period. Important gains from this reduced level are not expected to occur until after 1960, when the high birth rate of the early 1940's results in an increase in the number of persons of marriageable age. Since growth in the number of families directly adds to the demand for living quarters, the abrupt decline in this rate of growth could have serious repercussions on residential construction activity.

Improving housing standards

Although household formation is destined to decline, this does not necessarily mean that home building will contract accordingly. Construction of permanent dwelling units may either be substantially higher or lower than the number of new households established. If it is higher, the margin of difference will rep-

resent substitution of new for existing dwellings in the housing inventory through demolitions, abandonments, and perhaps an increase in the number of vacancies. If it is lower, the need for additional housing is being met in part by more intensive utilization of the existing housing inventory.

Before 1950, the growth in households had substantially exceeded the volume of permanent nonfarm housing starts for two decades. From 1940 to 1950 alone, the margin of difference amounted to more than 3 million units. This additional demand for housing was met in various ways. According to the Bureau of Labor Statistics, roughly 1,750,000 dwelling units were added through alteration of existing structures, including the cutting up of apartments, conversion of nonresidential into residential buildings, and utilization of basement and attic space for separate living quarters. In addition, about 700,000 units were created through increased use of marginal housing, such as trailers, tourist cabins, and one-room apartments, and 600,000 dwellings were supplied through erection of temporary public housing.

This points directly to the second source of housing demand—improvement of the existing housing inventory. There always are many people who are dissatisfied with their present living quarters and desire to move to more adequate housing as soon as they can. The number of such families is probably quite large now. Although many of the converted apartments undoubtedly are quite adequate, it seems likely that many others are sub-standard in terms of size or condition. Certainly most of the temporary public units should be abandoned in the next few years and a large proportion of the marginal units are unsatisfactory as year-round living quarters. Moreover, the 1950 Census of Housing revealed that nearly 2.5 million urban dwellings were “dilapidated” but still in use, and that an additional 7 million units lacked either running water or a private bathroom.

Also important in the desire of families to improve their housing standards is the very high birth rate of recent years. Since the war, births have remained steady at a rate of 3.7 million per year, as compared with less than 2.9 million during the prosperous 1920's. The trend toward larger families in the younger age groups must exert considerable pressure to move to better and more spacious living quarters.

Desire vs. effective demand

The question remains as to whether the desire for better housing will be converted into effective demand for new construction. In large part, the answer to this will be determined by the financial position of prospective buyers, the availability of financing, credit terms, and by the price and competitive appeal of new housing as compared with existing dwellings.

The first condition—that of financial capacity—depends upon maintenance of a high level of economic activity. At present, employment is at a record high and unemployment near a peacetime low, real per capita income after taxes is 50 per cent higher than in the

Replacement needs could fill the housing gap

	1950-1960 (thousand units)
Household formation, March 1950-July 1960	7,270
Replacement needs:	
Dilapidated units in use, 1950	2,500
One-fourth the units which will become dilapidated during the decade....	350
Losses from disasters	250
Removal of temporary public housing	600
Removal of one-half the marginal dwelling units added in the 1940's.	350
Reconversion of one-fourth the apartment conversions added in the 1940's	450
	11,770
Less housing starts, 1950-52	3,620
Total potential housing needs, 1953-60	8,150

late 1930's, and financial savings are accumulating at a pace exceeded only during the war years. Availability and terms of financing depend upon the continued willingness and ability of financial institutions to supply mortgage money and also upon Government housing and credit policy.

That replacement demand *could* be sufficient to maintain the rate of residential construction is demonstrated in the accompanying table. Added to the demand stemming from expected household formation during the decade, total new housing requirements as so calculated would call for an annual average production of 1.1 million units, a figure roughly equal to the 1952 volume. This process of substituting new for existing houses has already been going on for some time. In the past three years, housing starts have exceeded household formation by a total of about 900,000 units.

If construction activity is maintained near current levels, replacement demand will continue to bulk large in the totals. The problem lies in removing replaced housing from the market. This can take place only through a rise in vacancies of sub-standard units to the point where income of the properties falls below operating costs. For the most part, however, replacement of new for the least desirable existing dwellings will occur through a filtering down of better housing standards from one economic class to another, rather than by a direct substitution of new for old quarters by the present occupants. Even under conditions of strong demand and high incomes and employment, this process is not likely to work smoothly. Consequently, some increase in vacancies at all housing levels seems likely to occur, with depressing effects upon market prices generally.

Fortunately, from the standpoint of market strength, vacancies of habitable year-round dwellings have been very low during the postwar period. In 1950, effective vacancies of rental and "for sale" units combined accounted for only 1.7 per cent of the housing inventory.

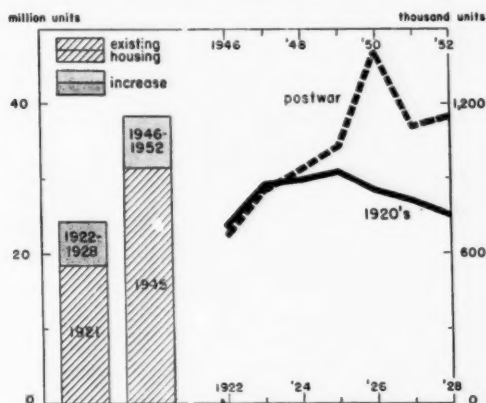
It is impossible to know at what point vacancies would seriously depress market prices for existing housing and thus make new construction relatively unattractive, but it seems likely that the ratio could rise substantially from the 1950 level. Moreover, a small increase in the vacancy ratio would involve a large number of dwellings; for example, a 5 per cent ratio would require an additional 1.2 million vacancies.

New housing demand highly volatile

The volume of residential construction influences and, in turn, is strongly influenced by the level of general economic activity. In the past, home-building activity has fluctuated violently with major changes in employment and personal income. From the peak of the housing boom in the 1920's to the depths of the depression in the early 1930's, permanent housing starts dropped 90 per cent. On the other hand, starts in the peak postwar year, 1950, were nearly 50 per cent above 1925, the best year of the 1920's.

The reasons for this instability are not difficult to spot. Purchase of housing almost

Postwar housing starts have exceeded the 1920's, but added a smaller proportion to the housing inventory



always involves a major long-term financial commitment in the form of contractual repayments on a mortgage. To enter into such an agreement requires confidence on the part of the buyer that family income will be maintained, and on the part of the lender that the loan will be repaid. Such confidence usually is lacking when incomes are falling and unemployment rising.

Moreover, housing is the most durable of all consumer products. The urban housing inventory now is well in excess of 40 million units. Even in a boom year, new construction affects this total only slightly. For this reason, a rate of construction well in excess of household formation makes its influence on housing standards felt only gradually and thus could continue for several years before replacement demand became satiated. By the same token, however, housing standards would deteriorate only slowly if construction fell well below the rate of family formation.

Because of the decline in household formation, it seems clear that the basic movement in the demand for new housing will be downward in the years ahead. The decline, however, could be offset or postponed by a replacement demand which reflects the desire of many families to improve their housing standards. Although many factors are involved in converting this desire into effective demand, the most important is continued high levels of employment and further gains in real family income.

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Private debt *continued from page 4*

in the postwar period. Financial debt, however, which represents principally loans for the purchase of securities, declined 4 billion.

Debt position appraised. As in the case of the corporate sector, the position of noncorporate debtors, when the debt is related to incomes and other economic variables, shows a deterioration from the early postwar period, but is still appreciably stronger than in peak prewar or pre-depression years. And as in the previous case, the strong current position stems from two developments: (1) the steady easing in credit terms, which has resulted in a smaller servicing burden per dollar of debt; and (2) the tremendous growth of incomes and asset holdings in the past decade.

The fact that long-term mortgages made up a large proportion of the debt expansion was a major factor limiting the size of the debt burden, since mortgage rates have been lower than the rates on most other types of household debt. Moreover, the spreading of amortization over longer periods and the fact that a part of the service charges on mortgages has replaced rent have also helped to ease the burden.

In relative terms, noncorporate debt is now 57 per cent of disposable income. This is much lower than in the years preceding the war, when the ratio was nearly 75 per cent.

Long-run implications

Thus when viewed from an over-all standpoint, the position of private debtors seems relatively strong—certainly stronger than in the late Twenties or in the years preceding the war. Current debts can readily be serviced from present levels of income.

The crucial problem is to maintain income and employment at high levels. In this circumstance, private debt would probably continue to rise. Should national income turn down, however, the picture would be altered. And in the face of declining income, efforts to reduce debts would almost surely intensify the downward adjustment.

In Seventh District banks—

new peak in profits

NET PROFITS of District member banks climbed to a new all-time high in 1952. At 118 million dollars they stood 10 per cent higher than the 1951 total, and well above the previous peak set in 1945. But a glance behind the figures suggests that the net improvement was more apparent than real.

In terms of gross earnings alone, a moderate gain was realized by banks throughout the District. Interest on loans topped the corresponding 1952 figure by 15 per cent, and interest on Government securities was one-tenth higher.

Operating expenses, however, also continued to rise. Salary costs increased 11 per cent at banks in both large and small centers. Outlays in the form of interest on time deposits rose even more. As a result, the increase in net current earnings was held to 20 million, distributed nearly proportionately among banks in and outside the District's leading cities.

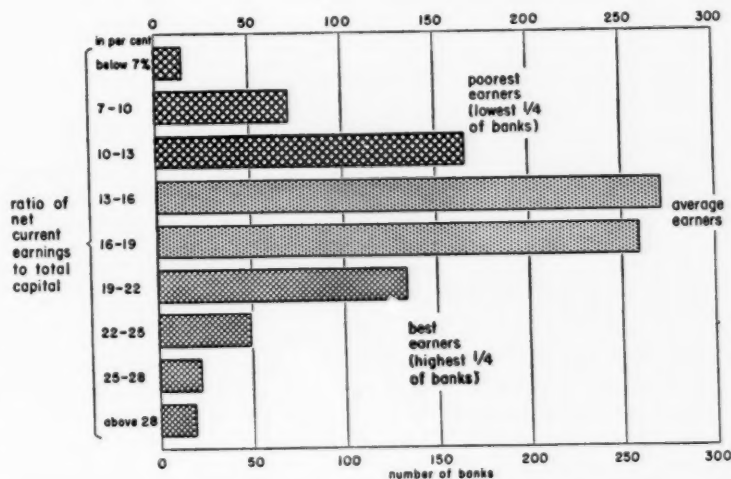
This advance in current earnings, in turn,

was more than absorbed by a 22 million jump in taxes levied on net income. Thus, except for changes in loss accounts, total net profits of District member banks would have dropped slightly below 1951 levels.

A 37 per cent drop in charges against income for losses was the ultimate contributor to the rise in District bank net profits. In good part, this drop reflected the fact that numerous banks had reached the statutory ceiling in their accumulated tax-allowable additions to loan reserves. Since Chicago banks had made particularly large transfers of this type up through 1951, theirs was the sharpest cutback in loss deductions in 1952. Country banks, on the other hand, were able to step up transfers over a year ago. Consequently, reported net profits increased 15 per cent in Chicago but only 2 per cent at banks in smaller centers. Yet in the Chicago banks, actual net funds available (net profits plus net additions to loss reserves) were not much above 1951 levels.

How net current earnings vary in District banks

Among District member banks, the ratio of 1952 net current earnings to capital ranged from a low of 1.4 to a high of 40 per cent. Fully one-fourth of the banks had a ratio below 13 per cent. At the same time, none of the highest earning fourth reported ratios below 19 per cent. The average for all District members combined was 16 per cent on capital.



from earnings to profits

THE GAP between a bank's net current earnings and its final net profit is often a big one. Two main deductions intervene: (1) actual losses, or transfers to reserves to cover future losses; and (2) taxes on net income.

The powerful leveling influence of these two deductions upon 1952 profits is indicated in the charts.

District banks with and without loan valuation reserves are charted separately.

Between the lowest earning and highest earning banks, both taxes and loss deductions increase more rapidly as a per cent of capital than do net current earnings. In the case of loss deductions, this happens in part because high earning banks tend to hold more risk assets on which losses can be taken. Tax payments are progressive because the flat dollar exemptions and the graduation in corporate tax rates reduce the effective rate paid by small earners, while the excess profits tax hikes the rate for high earners.

